Course objective, content, and organization

This course will provide students with hands-on experience analyzing financial statements. Students will learn about the theoretical concepts of fundamental analysis, general tools of financial analysis, and practical valuation issues. By the end of the course, students should be comfortable using firms' financial statements (in conjunction with other information) to develop an understanding of firm performance and make reasonable valuation estimates. The course does not assume market efficiency—it develops techniques to challenge traded prices and assess whether they are reasonable.

We use an integrated framework that combines strategy, financial reporting, financial analysis, and valuation. Early in the course we develop an accounting-based valuation framework that requires understanding, organizing, and summarizing financial data. After establishing the theoretical foundations of our model, we conduct the following analyses:

(i) A reporting strategy analysis, which entails:
   a. assessing a firm's value proposition and identifying key value drivers and risks
   b. evaluating the degree to which a firm's accounting policies capture the underlying business reality
   c. assessing a firm's earnings quality
   d. making accounting adjustments to eliminate GAAP issues and management biases

(ii) A performance analysis and valuation, which entails:
   a. evaluating current performance and its future sustainability
   b. making forecasts of future profitability and risk
   c. valuing businesses using earnings and book value data
We apply the above framework to a variety of business valuation contexts, including equity-investment analyses, IPOs, and mergers.

The class is a mix of lectures, cases, discussions, exercises, and project work. The required text is *Financial Statement Analysis and Security Valuation*, 5th edition (2013), by Stephen H. Penman, Irwin/McGraw-Hill publishing. The book is an excellent resource for those interested in deeper analysis, and it contains more material than we cover in class. Teaching notes, which I will distribute in class, contain most of the relevant course materials. Students cannot share course materials with anyone not currently enrolled in the course.

**Who should take this course?**

Students should take this course if they expect to use financial statements to evaluate a business’s performance, prospects, and value. This is relevant for students who want to pursue careers in investment banking (particularly in equity research), security analysis, private equity analysis, or corporate finance.

**Connection to the core**

The learning in this course utilizes, builds on and extends concepts covered in the core:

<table>
<thead>
<tr>
<th>Core Course</th>
<th>Concepts</th>
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<tbody>
<tr>
<td>Financial Accounting</td>
<td>• The accounting equation (A = L + OE), and the different financial statements (BS, IS, OE and CF)</td>
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<td>• Accrual accounting concepts (e.g., realization, matching, conservatism) and cash versus accrual accounting</td>
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<td>• Revenue recognition – rules and judgment</td>
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<td>• Individual line items (e.g., AR, PPE, Investments, Bonds, Leases, Tax)</td>
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<td>• Basic financial statement analysis (e.g., ratios)</td>
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<td>Corporate Finance</td>
<td>• Firm valuation models</td>
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<td></td>
<td>• Risk and cost of capital (WACC, CAPM)</td>
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<td>• Time value of money</td>
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<td>• Excel modeling</td>
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<tr>
<td>Strategy Formulation</td>
<td>• Sources of economic value</td>
</tr>
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</table>

Students are expected to have mastered these concepts and be able to apply them in different settings.
Evaluation Method

Your grade will consist of a project (40%), an exam (30%), problem sets and in-class assignments (20%), and class participation (20%). (I will reduce the weight on your lowest component by 10%.) Note that you need a passing grade on both the project and the exam to pass the course.

(i) Project (40%) – A group project where you conduct a complete financial statement analysis of a firm using the course framework, and provide an investment recommendation. The project is due by Monday, April 23, 2018. It is a Type A assignment.

(ii) Exam (30%) – A three-hour take-home exam. In order to give you time to take the exam, we will not have class on Tuesday, March 27, 2018. The exam will test you on the principles of fundamental analysis. It is a Type C assignment.

(iii) Problem sets and in-class assignments (20%) – See schedule for due dates. These assignments include problem sets, pre-case write-ups, and brief company analyses. Submitting and receiving full credit on seven out of nine such items is sufficient for full credit (20%). You may work on the assignments with others, but you must submit your own written version on the due date listed in this syllabus. The problem sets and in-class assignments are Type B assignments. I will grade them based on effort.

(iv) Class participation (20%) – I will grade class participation based on attendance, on-time arrival, professional behavior during class, and participation in class discussions. Professional behavior includes staying for the entire class session, refraining from private conversations, and not using computers, tablets, or phones. Participating in class discussions includes preparing for class, providing thoughtful answers to questions, and sharing your insights during class discussions.
**Schedule (tentative and subject to change)**

**Pre Course:**
- Review and refresh your knowledge of the core concepts mentioned above.
- Skim Penman Chapters 1-4.
- Read the Hurry Date case

1. Tues., Jan. 23:  Introduction and Overview; The Framework; An Accounting Based Model for Valuation (The Residual Earnings Model)
   - Read: Penman Chapter 5
   - Case: Hurry Date

2. Thurs., Jan. 25:  An Accounting Based Model for Valuation (Continued)
   **Assignment 1 is due on Tuesday, January 30, 2018:**
   - Penman E4.12 (page 136) and E5.9 (page 170)

   - Read: Penman Chapter 7
   - Skim: Penman Chapters 3 and 4

4. Thurs., Feb. 1:  NO CLASS

5. Tues., Feb. 6:  The Residual Earnings Model and Alternative Valuation Models (Continued)
   **Assignment 2 is due on Thursday, February 8, 2018:**
   - Penman M5.2 (page 174) and E7.8 (page 226)

6. Thurs., Feb. 8:  Prepare to Forecast: Reformulation of the Financial Statements
   - Read: Penman Chapter 8
   - Skim: Penman Chapters 9, 10 and 11

7. Tues., Feb. 13:  Prepare to Forecast (Continued)
Assignment 3 is due on Thursday, February 15, 2018:
Target Case Questions

8. Thurs., Feb. 15: Financial Ratios
   Read: Penman Chapters 12 and 13
   Case: Target Corporation: Ackman versus the Board


Assignment 4 is due on Thurs., February 22, 2018:
Penman E10.5 (page 326) and E13.4 (page 422); Home Depot Case Questions

    Read: Penman Chapters 17 and 18
    Cases: Home Depot

11. Tues., Feb. 27: Accounting Analysis and Valuation (Continued)

    Project Deadline 1 (March 1, 2018):
    Group, Company, Industry and Strategy (bullet point level)

    Assignment 5 is due on Thursday, March 1, 2018:
    Ryanair Case Questions

12. Thurs., Mar. 1: Putting it all together: Plain Vanilla Valuation
    Skim: Penman Chapters 14, 15 and 16
    Case: Ryanair Holdings

13. Tues., Mar. 20: Understanding the Business; Exam Review

    Assignment 6 is due on Thursday, March 22, 2018:
    Penman E12-3 (page 387)


15. Tues., Mar. 27: Exam (No Class)

16. Thurs., Mar. 29: Accounting Analysis I
    Case: Boston Chicken
Assignment 7 is due on Tuesday, April 3, 2018:
Krispy Kreme Case Questions

17. Tues., Apr. 3:  Forecasting I
    Case:  Krispy Kreme Doughnuts

Project Deadline 2 (Thursday, April 5, 2018):
Data, Ratios, preliminary Forecast and Valuation

18. Thurs., Apr. 5:  Accounting Analysis II
    Cases:  Bausch & Lomb

Assignment 8 is due on Tuesday, April 10, 2018:
Corrections Corporation of America Case Questions

19. Tues., Apr. 10:  Forecasting II
    Cases:  Corrections Corporation of America

20. Thurs., Apr. 12:  Applications: M&A
    Cases:  Schneider and Square D

Assignment 9 is due on Tuesday, April 17, 2018:
UPS Case Questions

21. Tues., Apr. 17:  Applications: IPO
    Cases:  UPS IPO

22. Thurs., Apr. 19:  Conclude

Group Project is due, Monday, April 23, 2018

23. Tues., Apr. 24:  Project Presentations

24. Thurs., Apr. 26:  Project Presentations (Continued)